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No. 96-1375

In the Supreme Court of the United States

OCTOBER TERM, 1996

ST. PAUL-RAMSEY MEDICAL CENTER, INC.,
PETITIONER

v.

DONNA E. SHALALA, SECRETARY
OF HEALTH AND HUMAN SERVICES

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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19 pp

QUESTION PRESENTED

Under a 1986 amendment to the Medicare Act, 42 U.S.C. 1395ww(h), Congress enacted a new methodology for reimbursing graduate medical education (GME) costs incurred by hospitals that participate in the Medicare program. The amendment directed the Secretary of Health and Human Services to "determine," for each hospital's cost reporting year that began during fiscal year 1984 (the base year), the "average amount recognized as reasonable" under the Medicare Act for direct GME costs for each full-time-equivalent resident. 42 U.S.C. 1395ww(h)(2)(A). The amendment further directed the Secretary to use that base-period per-resident amount, adjusted for inflation, to calculate the hospital's GME cost reimbursement for reporting periods beginning on or after July 1, 1985. 42 U.S.C. 1395ww(h)(2); see 42 C.F.R. 413.86. The question presented is:

Whether the Secretary reasonably construed 42 U.S.C. 1395ww(h) to authorize the reaudit of a hospital's previously approved, but possibly unreasonable or nonallowable, GME costs incurred in the base year, for the purpose of determining the reimbursement due in subsequent years.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-3a) is reported at 91 F.3d 57. The opinion of the district court (Pet. App. 4a-8a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on July 26, 1996. The petition for rehearing was denied on September 30, 1996. Pet. App. 9a. Justice Thomas extended the time within which to file a petition for a writ of certiorari to and including February 27, 1997, and the petition was filed on that date. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. In Title XVIII of the Social Security Act, Congress established the federally funded Medicare program to provide health insurance to the elderly and disabled. 42 U.S.C. 1395 *et seq.* Part A of the program provides insurance for covered inpatient hospital and related post-hospital services.[1] When eligible patients receive those services, the Secretary reimburses the providers of the services under the Medicare Act and the Secretary's implementing regulations. Under the regulations, the costs of certain educational programs for health professional trainees, including programs for interns and residents known as graduate medical education (GME) programs, are "allowable cost[s]" for which a hospital may receive reimbursement under Medicare Part A. 42 C.F.R. 413.85(a).

A provider's total allowable Medicare payment is based on a "cost report" that it must prepare after the close of its fiscal year. 42 C.F.R. 405.1801. The cost report is filed with a "fiscal intermediary" (usually an insurance company) designated by the Secretary. It shows the provider's costs and the percentage of those costs allocated to Medicare services. 42 C.F.R. 413.20(b), 413.24(f). The intermediary analyzes the cost report, audits it if necessary, and issues the provider a written "notice of amount of program reimbursement" (NPR) containing the final determination of the total amount to be paid for Medicare services during the reporting period. 42 C.F.R. 405.1803.

[1] Part B is a voluntary supplementary insurance program covering physicians' charges and other medical services. 42 U.S.C. 1395k, 1395*l*, and 1395x(s).

A provider dissatisfied with the NPR may timely request a hearing before the Provider Reimbursement Review Board (PRRB). 42 U.S.C. 1395*oo*(a) and (b); 42 C.F.R. 405.1835, 405.1837. The PRRB's decision is "final" unless, within 60 days, the Secretary reverses, affirms, or modifies it. 42 U.S.C. 1395*oo*(f)(1). By regulation, a determination by the intermediary, the PRRB, or the Secretary may be "reopened" within three years (or at any time if there has been fraud) with respect to findings at issue in the determination. 42 C.F.R. 405.1885, 405.1807.[2]

2. From 1966 through 1982, providers of services under Part A ordinarily were reimbursed for Medicare-covered patient care to the extent the costs were reasonable. 42 U.S.C. 1395f(b)(1). The reasonable cost calculation generally was based on the "cost[s] actually incurred," as long as the services were necessary. 42 U.S.C. 1395x(v). The Act authorized the Secretary to issue regulations defining the payment due under that statutory standard. 42 U.S.C. 1395hh, 1395x(v)(1)(A). In 1983, Congress introduced a prospective payment system (PPS) that establishes fixed payment rates for the operating costs of

[2] Providers may obtain judicial review of any "final decision" of the PRRB or of the Secretary, if the Secretary excercises the right of review. 42 U.S.C. 1395*oo*(f)(1). They may also obtain expedited judicial review of any action taken by a fiscal intermediary "which involves a question of law or regulations relevant to the matters in controversy," if the PRRB determines that "it is without authority to decide the question" or fails to make a timely determination of its authority to decide the question. 42 U.S.C. 1395*oo*(f)(1). The Board is authorized by regulation, 42 C.F.R. 405.1842(g)(2), to deny expedited judicial review if it finds that the issue on which review is sought is intertwined with disputed factual or legal issues that it is authorized to decide.

providing inpatient care to program beneficiaries. See 42 U.S.C. 1395ww(d) (1988 & 1991 Supp. III). Costs incurred in connection with GME programs were excluded from the PPS scheme. Until July 1985, hospital GME costs continued to be reimbursed on a "reasonable cost" basis. 42 U.S.C. 1395ww(a)(4) and (d)(1)(A) (1988 & 1991 Supp. III).

In the Consolidated Omnibus Budget Reconciliation Act (COBRA) of 1985, however, Congress changed the method for calculating GME costs by providing that, subject to updating for inflation, the calculation of GME costs to be reimbursed in all subsequent years would be based on the amount of allowable GME costs incurred by the provider for a fiscal year that began between October 1, 1983, and September 30, 1984 (the base year). See Medicare and Medicaid Budget Reconciliation Amendments of 1985, Pub. L. No. 99-272, Tit. IX, § 9101, 100 Stat. 153-155, 42 U.S.C. 1395ww(h) (the GME Amendment); see also 42 C.F.R. 413.86(e)(1)(i)(A). Specifically, the GME Amendment provides, as the initial step in the reimbursement process, that "[t]he Secretary shall determine [for the base year] the average amount recognized as reasonable" under the Act for direct GME costs for each full-time equivalent (FTE) resident. 42 U.S.C. 1395ww(h)(2)(A). Thus, the Secretary was directed to calculate a per-resident amount for each hospital by dividing the amount of GME costs "recognized as reasonable" for the base period of 1984 (numerator) by the number of FTE interns and residents working at the hospital in 1984 (denominator). To determine a hospital's GME reimbursement for any given year, the allowable GME per resident amount, adjusted for inflation, is multiplied by the number of FTE residents working in the hospital during the year in question and the hospital's Medicare patient load that year. 42 U.S.C. 1395ww(h)(3). Congress instructed the Secretary to apply the new method retroactively to "hospital cost reporting periods beginning on or after July 1, 1985." GME Amendment, § 9202(b), 100 Stat. 175.

On September 21, 1988, the Secretary published and invited comment on proposed regulations implementing the GME Amendment. 53 Fed. Reg. 36,589 (1988). Although the Secretary already had reimbursed most hospitals for 1984 GME costs, and in some cases the three-year period for administratively reopening the determinations relevant to those payments had expired, the proposed regulations authorized fiscal intermediaries to reexamine providers' costs from the base year and to conduct a reaudit if the claimed base year costs appeared to include "misclassified or non-allowable costs," or were "unreasonably high." *Id.* at 36,592. The Secretary explained that the agency had reason to believe some "questionable" GME costs had been "erroneously reimbursed" to providers for the base year. *Id.* at 36,591. Because the Secretary concluded that those past mistakes should not be "perpetuated" under the new GME cost reimbursement methodology, the reauditing authority was needed to ensure an "accurate" determination of providers' base-year GME costs. *Id.* at 39,591-39,592. The Secretary believed that "the provisions of section 1886(h) of the Act would seem to require that we correct these discrepancies in the base period since there is no provision in the law for correcting them later." *Id.* at 36,593.

In the preamble to the final regulations, issued on September 29, 1989 (see 54 Fed. Reg. 40,286-40,301 (1989)), the Secretary reiterated that it was "hard to

believe that Congress intended that misclassified and nonallowable costs continue to be recognized through the GME payment indefinitely." 54 Fed. Reg. 40,301 (1989). The Secretary assured providers that, in reauditing 1984 GME costs, "no new reimbursement principles will be applied * * * ; [r]ather, our intent is to ensure that the reimbursement principles in effect during the GME base period were correctly applied." *Ibid.* In response to comments that the proposed reexamination and reaudits conflicted with the three-year reopening limitation in 42 C.F.R. 405.1885, the Secretary stressed that the reaudits would not be used to recoup erroneous reimbursement for cost reports that had been settled for more than three years under the reopening regulation. 54 Fed. Reg. 40,302 (1989). Rather, they would be used to recalculate base year costs "solely for purposes of computing the per resident amount" under the new method for reimbursing GME costs for 1985 and "subsequent years still subject to reopening." *Id.* at 40,301, 40,302.[3]

In late 1990, fiscal intermediaries began to conduct redeterminations of GME base-year amounts for teaching hospitals that provide Medicare services, including petitioner St. Paul-Ramsey Medical Center. The reaudit of petitioner resulted in a determin-

[3] The Secretary also modified 42 C.F.R. 405.1885 to permit hospitals to request a reopening of a cost report settled more than three years before if the reaudit resulted in a disallowance based on "misclassified" base period GME costs. 54 Fed. Reg. at 40,301. The purpose of that modification was to allow the hospitals to demonstrate that, if the reaudit showed the disallowed cost should have been classified as an operating rather than a GME cost, their reimbursement rate for operating costs should be increased. *Ibid.*

ation that petitioner's allowable GME costs for its base year were $5,494,955, which was $4,397,689 less than the $9,892,644 in GME costs the intermediary approved on February 28, 1986. See Pet. App. 2a.[4] On August 13, 1991, petitioner appealed the intermediary's determination to the PRRB. Pet. 8; Admin. Rec. 119. Petitioner challenged the validity of the GME regulation authorizing the reaudit, arguing that the GME Amendment required the Secretary to determine petitioner's average amount of reasonable GME costs for the base period by using the amount reflected in petitioner's NPR for the base period and reimbursed by the Secretary, and not the amount resulting from the reaudit. On September 28, 1994, the PRRB concluded that it lacked authority to invalidate the GME regulation, thereby allowing petitioner to seek expedited judicial review under 42 U.S.C. 1395*oo*(f)(1). Admin. Rec. 1-4; see note 2, *supra*.

5. Petitioner filed suit in the United States District Court for the District of Minnesota challenging the validity of the GME reaudit regulation. On the parties' cross-motions for summary judgment, the district court upheld the GME reaudit regulation.

[4] Although it was evident that petitioner had received excessive reimbursement for 1984 GME costs, no recoupment action was taken against it by the intermediary or the Secretary because petitioner's 1984 cost report had been settled for more than three years and could not be reopened under 42 C.F.R. 405.1885. Instead, the intermediary notified petitioner that it would use the reaudited GME cost amount solely to determine petitioner's reimbursable GME amount for all cost reporting years beginning on or after July 1, 1985, for which the three-year reopening period had not already elapsed. Pet. 7-8; see 42 C.F.R. 413.86(e)(1)(iii).

Pet. App. 4a-8a. The court observed (*id.* at 7a) that petitioner's arguments supporting its challenge to the reaudit regulation had been considered and rejected by the District of Columbia Circuit in *Administrators of the Tulane Educational Fund* v. *Shalala*, 987 F.2d 790 (1993), cert. denied, 510 U.S. 1064 (1994) (see Pet. App. 38a-54a), and by the District Court for the Northern District of Ohio in *The Toledo Hospital* v. *Shalala*, No. 3:94cv7080 (June 23, 1995), rev'd, 104 F.3d 791 (6th Cir. 1997). The court found those decisions "persuasive, thorough, well-reasoned and indistinguishable from the present case." Pet. App. 8a. Accordingly, the court "adopt[ed]" the analyses of those decisions and granted summary judgment in favor of the Secretary. *Ibid.*

6. The court of appeals affirmed. Pet. App. 1a-3a. The court explained that "the Secretary's reaudit regulations must be upheld for the reasons persuasively stated by the D.C. Circuit in *Tulane*." *Id.* at 3a. Thus, the court concluded that "[t]he statute is ambiguous, and the reaudit regulations are not an exercise in retroactive rulemaking." *Ibid.* The court observed that "[w]hile it would have been far preferable had the Secretary promulgated the reaudit regulations during the three-year reopening period governing 1984 reimbursements, the substance of the regulations is clearly reasonable." *Ibid.*

ARGUMENT

The court of appeals correctly sustained the Secretary's construction of the GME Amendment and the regulation allowing reaudits of base period GME costs in determining the average of amount of costs "recognized as reasonable" under the Medicare Act. We nevertheless agree with petitioner that the Court

should grant certiorari in this case. A recent decision of the Sixth Circuit, *The Toledo Hospital* v. *Shalala*, 104 F.3d 791 (1997) (see Pet. App. 20a-37a), is in conflict with the decision below and the decision of the D.C. Circuit in *Tulane*, and the question presented is of sufficient importance to warrant this Court's review.

1. a. The court of appeals properly applied the two-step analysis of this Court's decision in *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842, 843 (1984). In the GME Amendment, Congress directed the Secretary to "determine" for each teaching hospital the "average amount recognized as reasonable under this subchapter" for GME costs in fiscal year 1984, and to "determine" from that a per "resident amount." 42 U.S.C. 1395ww(h)(2). The court below correctly concluded that "[t]he statute is ambiguous." Pet. App. 3a. As the D.C. Circuit in *Tulane* pointed out, the phrase "recognized as reasonable" could be construed either as commanding the use of the reimbursement amount that had originally been calculated by the fiscal intermediary and had become final by operation of the three-year regulatory limitation on reopening, see 42 C.F.R. 405.1885 and 405.1807, or, alternatively, as permitting the use of an amount more recently determined to be "reasonable" through a reauditing process.

In petitioner's view (Pet. 12-16), the GME Amendment's direction to the Secretary to "determine, [for the base year], the average amount recognized as reasonable under this subchapter" required the Secretary to derive an "average" by dividing the amount already established in a hospital's audited NPR for cost reporting year 1984 (numerator) by the number

of full-time residents for that year (denominator). As the District of Columbia Circuit observed in *Tulane*, however, "[t]he statutory text certainly does not address this administrative dilemma directly," and there is "no convincing evidence, direct or indirect, that Congress meant to prohibit corrective reauditing of the 1984 GME cost figures." Pet. App. 46a; see also *id.* at 49a n.6 ("because the statute directs the HHS to '*determine*' the '*average*' amount of GME costs per FTE resident 'recognized as reasonable,' it seems unlikely that Congress intended for the HHS to simply look up a hospital's approved NPR for 1984 and plug it into the statutory formula").

In the face of the Act's ambiguity, the Secretary reasonably construed Congress's mandate to authorize a new determination of GME costs for the base year under the standard of reasonableness established by the Medicare Act. Further, because the Secretary could reasonably assume that "Congress would resist permanently ingraining misclassified and nonallowable costs in future reimbursement to health care providers," Pet. App. 51a, it was reasonable for the Secretary to adopt an interpretation that would minimize the chance of carrying forward past errors. Indeed, Congress has, by statute, specifically recognized the Secretary's implementation of the GME Amendment and, far from disapproving that implementation, has instead chosen only to mitigate its financial impact. See Section 4004(a) of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-39 (42 U.S.C. 1395ww note) (prohibiting, until October 1, 1991, the Secretary's recovery of GME overpayments accrued during cost reporting years 1985 through 1991 resulting from the new payment methodology of 42 U.S.C. 1395ww(h),

and limiting thereafter the recovery of those accrued overpayments to 25 percent of the amount of the overpayments in each of the succeeding four fiscal years).[5]

b. Contrary to petitioner's contention (Pet. 19-22), the court of appeals also correctly held that the reaudit regulation is "not an exercise in retroactive rulemaking." Pet. App. 3a. Congress expressly provided the Secretary some authority to issue rules retroactively, because it made the GME Amendment (which was enacted on April 7, 1986) applicable to cost reporting periods beginning on or after July 1, 1985. By necessary implication, the procedures for calculating GME costs in the GME regulations that the Secretary subsequently issued in 1989 may be used to calculate reimbursement for cost reporting periods beginning July 1, 1985.

The intermediary's reaudit of the base year does not introduce any additional element of retroactivity beyond the authority conferred by the GME Amendment itself. The reaudit figures are not used to recoup reimbursement for any cost-reporting year for which the three-year reopening period has elapsed. 54 Fed. Reg. 40,302 (1989); 42 C.F.R. 413.86(e)(i)(iii). Accordingly, the reaudit regulation neither takes

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[5] The Conference Report also makes clear that Congress was fully aware of the Secretary's implementation of the GME Amendment through recoupment of past payments determined to exceed the amount allowable under 42 U.S.C. 1395ww(h), "expect[ed] the Secretary to recoup overpayments identified as a result of implementing this policy over a four year period," and contemplated that the Secretary would not make continued overpayments following a determination that past payments exceeded the amount permitted by 42 U.S.C. 1395ww(h). H. R. Conf. Rep. No. 964, 101st Cong., 2d Sess. 719 (1990).

away nor impairs any rights petitioner acquired under previously existing law. See *Landgraf* v. *USI Film Products*, 511 U.S. 244, 269, 280 (1994). Similarly, because the reaudit regulation requires only a determination of past facts for purposes that have only prospective effect, the regulation does not make a retroactive change. 511 U.S. at 269-270 n.24 ("a statute 'is not made retroactive merely because it draws upon antecedent facts for its operation'" (quoting *Cox* v. *Hart*, 260 U.S. 427, 435 (1922)); *Reynolds* v. *United States*, 292 U.S. 443, 449 (1934) ("[a] statute is not rendered retroactive merely because the facts * * * upon which its subsequent action depends * * * are drawn from a time antecedent to the enactment"). For those reasons, the D.C. Circuit in *Tulane* correctly concluded that "within the limited statutory retroactivity, the Secretary's reauditing regulations add nothing further that is retroactive," because "the regulations contemplate only the use of past information for subsequent decisionmaking." Pet. App. 54a.

2. Although the decision of the court of appeals is correct, we agree with petitioner that the Court should grant certiorari in this case. The Sixth Circuit's recent decision in *Toledo*, *supra* (see Pet. App. 20a-37a), directly conflicts with the decisions of the court below and the D.C. Circuit in *Tulane*. In *Toledo*, the Sixth Circuit held that the GME Amendment required the Secretary to use the initial 1984 GME cost figures in calculating the reimbursement formula for future reimbursements and prohibited the use of reaudited figures. *Id.* at 30a-34a. The Sixth Circuit faulted the conclusion by the court below and the decision in *Tulane* that the language of 42 U.S.C. 1395ww(h)(2) is ambiguous. Pet. App. 28-29a.

It reasoned that because Congress "knew that there was an administrative scheme in place that would determine the reasonable GME costs for providers for fiscal [year] 1984," "Congress must have contemplated that the Secretary would use those administratively determined reasonable costs as the basis for calculating the average GME cost per full-time-equivalent resident." *Id.* at 30a-31a. The court also found that, even if the GME Amendment is ambiguous, the Secretary's construction was unreasonable. *Id.* at 34a-37a. Because the Sixth Circuit concluded that the reaudit regulation failed *Chevron*'s two-step analysis, the decision in *Toledo* directly conflicts with the instant decision of the Eighth Circuit and the decision of the D.C. Circuit in *Tulane*.

Furthermore, the proper interpretation of the GME Amendment presents an important and recurring issue that has a major fiscal impact on the administration of the Medicare program. More than 1,300 hospitals nationwide received notices of average per-resident amounts, reflecting the hospital's base year GME costs. The PRRB's records reflect that 624 hospitals sought administrative review of those notices. As of mid-April 1997, 84 administrative appeals were still pending. Moreover, the Secretary believes that the hospitals affected by the GME Amendment will continue to seek judicial review of the validity of the reaudit regulation.[6] Even if the reaudit regulation remains invalid only in the Sixth Circuit, the *Toledo* decision nonetheless will have significant

[6] Another challenge to the GME reaudit regulation is pending in the United States District Court for the District of Arizona. *Samaritan Health Systems* v. *Shalala*, No. CIV 95-1032 PHX-RCB (filed May 24, 1995).

financial impact on the Medicare program. There are 17 pending administrative appeals that could be affected by the Sixth Circuit's decision. We have been informed that for those hospitals alone, the amount at stake for past fiscal years could exceed $100 million. Thus, the Court's resolution of the Secretary's authority under the GME Amendment is warranted.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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